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Central Intelligence Agency



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DIRECTORATE OF INTELLIGENCE

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HONG KONG: THE TALKS BEGIN IN EARNEST

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Summary

Despite concerns in London and Beijing over the health of the Hong Kong economy, neither side appears prepared to make major concessions that would lead to an early breakthrough in the talks on the colony's future. In our view, it will be especially difficult to bridge the gap between Britain's insistence on retaining a role indefinitely in managing Hong Kong (to build public confidence in a settlement) and China's plan to convert Hong Kong into a special region administered by local Chinese. The fundamental difference between the two sides is what guarantees are necessary to alleviate concerns in Hong Kong and abroad that China will radically alter the colony's way of life once it regains sovereignty.

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The stalemate has generated considerable uneasiness in Hong Kong. The possibility of another more serious downturn in the economy remains high. Indeed, we believe that unless the British and Chinese demonstrate some progress, the local currency will probably continue to slide, the stock market will become more unstable, and the flight of people and capital will continue. Even with progress in the talks, the same events could occur if

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the people of Hong Kong continue to perceive the prospect of a Chinese takeover as threatening.

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Procedural Progress

The only real progress in the talks has been procedural, not substantive.

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The decline in the value of the Hong Kong dollar and local stock market that began in May accelerated in early June just as the agenda issue came up, resulting in substantial losses for Beijing in the Hong Kong dollar market. In setting aside the sovereignty issue, the Chinese almost certainly concluded that ultimately they will regain sovereignty and that the need for progress in the talks to bolster confidence in Hong Kong outweighed the diminishing returns from continuing to press the British on this point. Deng explained to the Hong Kong delegates to the National People's Congress on 25 June that once the issue of how Hong Kong is to be governed is settled, the issue of sovereignty will be readily solved.

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Atmospherics

The talks have created a pessimistic atmosphere in Hong Kong that threatens to create a self-fulfilling prophecy. The longer progress remains elusive in the talks, the more likely that confidence in the colony's future will slip. For example, the Hong Kong dollar and stock market fell drastically in late September after the 22-23 September round of talks made no apparent progress. Visa applications for emigrants and actual departures are both up. Even after the resumption of talks in July generated new hope for progress, a prominent local columnist wrote that the problem for most people is not when to decide to stay, but when to decide to run.

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Beijing's efforts to build confidence in the colony have been counterproductive. The lack of clarity in China's plans for Hong Kong has further weakened the value of Beijing's attempts to reassure the colony's residents of China's good intentions. Beijing is attempting to bolster Hong Kong's sagging economy by

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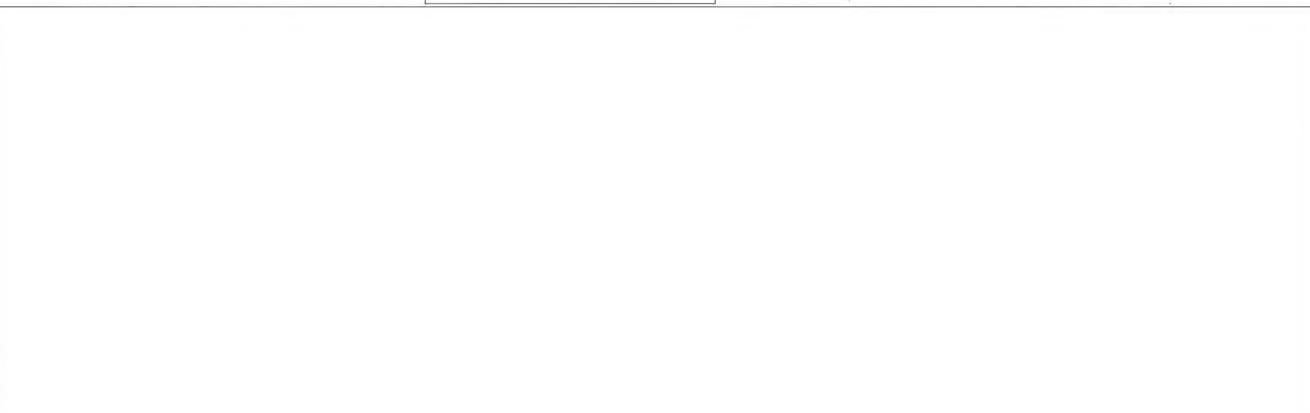
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increasing its investments and involvement in the colony. But continued large-scale Chinese economic involvement is likely to create fears that Beijing is trying to buy its way into Hong Kong, adding to the confidence problem. China's new senior representative in the colony, Xu Jiatusheng, has also contributed to Beijing's image problem because he has been perceived locally as a high-level cadre from Beijing who has little understanding of how Hong Kong works.

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Critical Issues in the Talks

Each issue in the talks could be solved in several ways and more than one agreement may be necessary to resolve Hong Kong's future. The following is a speculative guide to what a Sino-British settlement on Hong Kong might entail:

Administrative Authority:

Both sides recognize that any solution must be based on China regaining sovereignty over Hong Kong. The British view their continued involvement in Hong Kong's post-1997 management as essential to maintaining confidence. At present, the Chinese seem willing to allow the British to remain in Hong Kong as advisors or even members of a Beijing approved local leadership after 1997. The Chinese will probably insist that the city's chief executive be an ethnic Chinese. Beijing will want to appoint or at least be able to veto the selection of a chief executive, fearing that local elections could weaken its grip in Hong Kong. If Hong Kong's economy takes another turn for the worse, the British may try to exploit Beijing's fears to negotiate a stronger management role. At this point, however, there seems little chance the Chinese would accept a British offer to manage the city under Chinese sovereignty and only a slightly better chance that Beijing would agree to joint management.

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Transition Period

The Chinese will press for a gradual transition of management from the British to local Chinese to begin soon after an agreement is reached. One independent Chinese language newspaper in Hong Kong reported in April that the Chinese had proposed that in seven or eight years local Chinese should assume positions as principle deputies in all Hong Kong government departments. By 1993, the paper's source reported, the Chinese would want these people promoted to senior positions as a last step before a transfer of executive power in 1997.

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[redacted] The two sides could agree to set up a joint commission to oversee the transition, and deal with the unforeseen problems not addressed in the initial agreement. Another solution might be to extend formally the joint-rule transition period beyond 1997 to bolster confidence that Hong Kong's way of life will not change even under Chinese sovereignty.

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Guarantees

British and Chinese differences over what guarantees are necessary to maintain Hong Kong's stability and prosperity will be among the most difficult issues to solve. The British believe they have a responsibility to alleviate the concerns in Hong Kong and abroad that China will fundamentally alter Hong Kong's way of life once it regains sovereignty. Beijing is not likely to agree to a settlement which allows Britain to retain a policy making role in Hong Kong. The Chinese could agree to consult with the British on important decisions in Hong Kong. Even with British participation in a post-colonial government, Beijing could alter Hong Kong's structure at will. The British might be able to convince the Chinese to include a clause in an agreement stating that Hong Kong's existing way of life will not be altered during a specific period, such as Deng's 50-year proposal, but once China has sovereignty in Hong Kong there would be very little the British could do to halt changes. If the Chinese were to make unilateral and unpopular changes in Hong

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Kong, however, they would risk charges of bad faith, especially in Taiwan where Beijing hopes the Hong Kong settlement will be seen as a model for reunification.

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Legal System

Beijing's understanding of Hong Kong's legal system is particularly poor.

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[redacted] Retention of the legal system is critical to building public confidence.

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[redacted] The Chinese probably have only a limited familiarity with Hong Kong's laws. Only a fraction of the colony's laws have been translated into Chinese and nearly all legal proceedings are conducted in English.

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[redacted] China is planning to establish a judicial research center to study Hong Kong's judicial and legislative systems. Decisions about which laws will actually be carried over under Chinese sovereignty are probably years away.

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Creation of a new legislative structure will also be an issue. Beijing will probably be willing to retain a revised version of Hong Kong's legislative council, which is currently made up of Hong Kong's senior administrators and members of the community appointed by the Governor.

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As for civil rights, Beijing has expressed a willingness to allow the people of Hong Kong to maintain their current lifestyles. Britain will try to ensure that freedom of speech and press, the right to travel, and the right to own property, are all guaranteed in a Hong Kong settlement. We believe China will probably nominally agree to such guarantees, some of which already exist in China's constitution.

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Economic Structure

Because of its sizeable financial stake in Hong Kong, China appears willing to maintain the colony's existing economic system. We believe Beijing will agree to British suggestions that the Hong Kong dollar remain a freely convertible international currency. The Chinese will probably agree to continue having the dollar issued by two of the colony's banks.

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[redacted] Both sides should have little difficulty agreeing to maintain Hong Kong's stock market and the colony's tax structure, which favors investment. Hong Kong's laissez-faire economic structure has succeeded because of its lack of controls and because investors have always been confident that the British would not drastically change this system. More so than in any other area, we believe the British will press the Chinese to allow them to retain a role in order to maintain confidence. The British probably hope, in particular, to continue to fill the key position of Financial Secretary beyond 1997. Nevertheless, even with British participation, it is likely to be difficult to convince investors that Beijing will not fiddle with the city's strong capitalist system.

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Foreign Affairs

Continuation of Hong Kong's separate status in some international forums will probably be one of the easier issues to handle.

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Indications of Progress

Progress in the present talks could be indicated by the inclusion of technical experts and more senior officials on both sides. The Chinese team currently headed by Vice Foreign Minister Yao Guang includes two experts on international law and treaties, but only one member is thought to be familiar with Hong Kong's economic affairs.

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[redacted] Nevertheless, the complexities of Hong Kong's legal and economic structure will almost certainly

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require the inclusion of technical experts in the talks at some point, perhaps as part of working groups on specific subjects.

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If the British delegation was upgraded to include Minister of State Richard Luce, this could signal progress in the talks. Luce, a member of Parliament who has responsibility for Hong Kong at the Foreign Office, would be closer in rank to Yao Guang than Ambassador Craddock. Finally, there has been some speculation in the Hong Kong press that the popular former governor of the colony, Lord MacLehose, will join the talks.

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SUBJECT: Hong Kong: The Talks Begin in Earnest [redacted]

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Department of State

1 - Donald Anderson, Director, Office of Chinese Affairs,
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1 - Paul F. Gardner, Director, Office of Regional Affairs,
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1 - William A. Root, Director, Office of East-West Trade,
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1 - Charles Martin, INR/EAP

Department of the Treasury

1 - Douglas Mulholland, Liaison Officer

Department of Commerce

1 - David Peterson, Office of Intelligence Liaison

1 - Robert Perito, Chief, China Office, East Asian and Pacific

Office of the U.S. Trade Representative

1 - John E. Ray, Assistant U.S. Trade Representative

Export-Import Bank of the US

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2 - DDI (7E44)
1 - Chief, [Redacted] DDO
1 - D/OCR
2 - FBIS Analysis Group

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